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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 004240

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E.O. 12958: DECL: 08/27/2017

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SUBJECT: RUSSIA ENERGY: TNK-BP LOOKING INTO IRAQ,
TURKMENISTAN, INCREASING CAPEX

REF: ASHGABAT 877

Classified By: Econ MC Eric Schultz for Reasons 1.4 (b/d)

SUMMARY

1. (C) TNK-BP VP for International Affairs Shawn McCormick told us on August 24th that the company is venturing into Iraq, has sent a team to Venezuela with mixed results, and is optimistic about prospects in Turkmenistan. Its capital expenditure budget is up \$700 million in 2007 to \$3.4 billion and expected to rise again in 2008. U.S. firms appear poised to win a significant chunk of this year's contracts. The possible acquisition of the Russian shares of the company by either Rosneft or Gazprom is unlikely anytime soon as both suitors are finding it difficult to raise the \$20 - \$25 billion needed to make such a purchase and the TNK owners are still fighting amongst themselves. End summary.

TNK-BP LOOKING TO EXPAND INTERNATIONALLY

2. (C) During an August 24 lunch, McCormick told us the company's Deputy Chairman, German Khan, will travel to Erbil, Iraq this week to meet with Kurdish leader Massoud Barazani to talk about hydrocarbon prospects. McCormick said he declined to join Kahn due to security concerns. He will update us upon Khan's return. McCormick also told us a TNK-BP team just returned from Venezuela with the assessment that the geological potential of proposed sites offered to TNK-BP were good, but that there were serious doubts about the terms offered as well as the political situation there. McCormick said Lukoil had been given a "real dog" of a license, which Chavez had used to rope Russia into political support. Cuba had also invited TNK-BP, among others, to explore its waters but McCormick insisted that TNK-BP was not planning on sending a team to Cuba anytime soon. In response to our question, he said Iran has not been mentioned as a potential site for future expansion.

3. (C) McCormick was positive about TNK-BP's push into Turkmenistan, where it hopes to develop at least one field (in the Block 1 area) and possibly a second. He suggested that Petronas needs a partner. He added that BP is pursuing its own interests in Turkmenistan separately. Describing the difficulties of doing business there (as Ashgabat alluded to in reftel), McCormick said TNK-BP had been asked to develop a resort on the Caspian coast of Turkmenistan to gain more favorable consideration of its pursuit of hydrocarbons. Since TNK-BP is not in the resort-building business, McCormick said it was scratching its head trying to figure out next steps. He emphasized that TNK-BP is after oil, not gas, in Turkmenistan since transportation difficulties detract from the value of gas assets.

FUTURE OF TNK SIDE OF COMPANY STILL UNCERTAIN

4. (C) On the long-rumored sale of the TNK half of TNK-BP (owned 50% by Mikhail Fridman's Alfa Group, 25% by billionaire Viktor Vekselberg, and 25% by U.S. firm Access Industries), McCormick said the future is unclear. Only Gazprom and Rosneft would have the Kremlin's blessing to buy the Russian shares. But, given a valuation of between \$20-\$25 billion for the TNK half (based on market prices of TNK-BP's small free-float), neither can afford it right now. McCormick confirmed that banks have told TNK-BP they simply cannot lend more money to either of the over-extended state giants at this time. In any event, there is dissension among the TNK shareholders as some waffle over which state company might offer the highest price and others (especially Vekselberg) focus on parochial concerns related to how to

leverage such a sale into better positions for their other businesses.

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LARGE AND GROWING CAPITAL EXPENDITURE BUDGET

15. (C) McCormick said he wasn't concerned about possible GOR actions to bring TNK-BP (Russia's 3rd largest oil producer) under state control on the cheap. He suggested BP's 50% ownership helps protect the company, as a move against TNK-BP would further tarnish the Kremlin's reputation in the West. Senior TNK-BP management and ownership is confident in the company's future, as demonstrated by the \$700 million increase in the 2007 capital expenditure budget to \$3.4 billion, which is set to rise again in 2008. This, McCormick noted, is not what companies do if they think they could be taken over by the state, adding that Sibneft sent all its earnings out as dividends rather than reinvesting in the business before its sale to Gazprom.

16. (SBU) McCormick said TNK-BP was trying to accelerate its spending (it has only spent \$500 million of its capital expenditure budget this year), but lacks both the human capacity to manage it, as well as capable partners to supply it with the products and services it needs. He specifically asked us to point U.S. suppliers to opportunities with TNK-BP. On August 27, the company announced its second big tender of the summer -- a \$1.3 billion offer for workover rigs. In July the company announced a \$2 billion tender for drilling rigs. (Note: The human resource concern is often cited by companies as a major challenge in Russia. Like other companies, TNK-BP is pouring money into Russian higher-education institutions to train the people it needs for its continued success. End note.)

DUDLEY VISIT

17. (SBU) McCormick said that TNK-BP president (and Amcit) Bob Dudley would visit Washington October 17-18 and hoped to see senior officials at State, Energy, Commerce, the NSC, and others.

COMMENT

18. (C) TNK-BP's rising investment, international expansion efforts, and human capacity development plans clearly reflect a company convinced of its long-term sustainability. It is an example of the value that sophisticated international partners such as BP bring to their operations in Russia. If TNK-BP can remain independent, it will likely continue to be a force for good -- greater transparency, effective deployment of capital, and management efficiency -- in Russia's energy sector. In that regard, it is unquestionably fortunate that the souring of the credit markets has made it difficult for Gazprom and Rosneft to further expand their reach in the sector.

19. (C) Dudley's trip to Washington is a good opportunity for the USG to urge more U.S. company involvement in TNK-BP's growth and to explore the possibilities in third countries for cooperation with this unique half-western, half-Russian company.
Burns